

Message Text

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ACTION TRSE-00

INFO OCT-01 EA-07 NEA-10 ISO-00 AID-05 CIAE-00 COME-00

EB-07 FRB-03 INR-07 NSAE-00 USIA-06 XMB-02 OPIC-03

SP-02 CIEP-01 LAB-04 SIL-01 OMB-01 NSC-05 SS-15

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USADB

FOR NAC AGENCIES

PASS TREASURY FOR ZINMAN

E.O. 11652: ADS, DECLAS: 3/1/77

TAGS: EAID, EFIN, NP

SUBJECT: PROPOSED ADB COST OVERRUN LOAN FOR HETAUDA-NARAYANGARH

ROAD PROJECT IN NEPAL

REF: TREASURY 76-104

FOLLOWING IS SUBSTANCE OF ADB RESPONSE TO QUESTION RAISED

REFTEL AS TO WHY NEPAL IS NOT ABLE TO USE RESERVES TO

FINANCE COST OVERRUN INCURRED BY SUBJECT PROJECT:

1. ACCORDING TO THE LATEST FIGURES AVAILABLE,
NEPAL'S MERCHANDISE IMPORTS IN 1974-75, WHICH WERE PAID
IN CONVERTIBLE CURRENCIES, TOTALLED ABOUT \$54 MILLION OR
\$4.5 MILLION A MONTH. THIS AMOUNT, THEREFORE, IS IN
EXCESS OF ORIGINAL FORECAST OF \$2.7 MILLION, FIGURE
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MENTIONED IN REFTEL. (FOOTNOTE: \$2.7 MILLION APPEARS

TO BE BASED ON AN EARLY FORECAST. ORIGINAL CONVERTIBLE FOREIGN EXCHANGE BUDGET FOR 1974-75 SHOWED \$36 MILLION FOR MERCHANDISE IMPORTS FOR ENTIRE YEAR, OR MONTHLY AVERAGE OF \$3 MILLION.)

2. REGARDING USE OF NEPAL'S CONVERTIBLE CURRENCY RESERVES, FACT MAY BE NOTED THAT THEY HAVE NOW BECOME MUCH MORE A SUBSTITUTE FOR INDIAN RUPEE RESERVES. IN BRIEF, NEPAL'S INTERNATIONAL RESERVES (CONVERTIBLE CURRENCIES AND INDIAN RUPEES) HAVE TO BE VIEWED IN THEIR TOTALITY, NOT SEPARATELY. RECENTLY, NEPAL HAS BEEN PROCURING GOODS FROM INDIA WHICH ARE PAYABLE IN CONVERTIBLE FOREIGN CURRENCIES. AS AN AFTERMATH OF WORLD-WIDE OIL CRISIS, NEPAL HAS HAD TO PAY FOR PETROLEUM PRODUCTS FROM INDIA IN CONVERTIBLE CURRENCIES, WHEREAS IN PAST SUCH PAYMENTS WERE MADE IN INDIAN RUPEES. NEPAL HAS ALSO INCREASINGLY TURNED TO OVERSEAS COUNTRIES FOR CAPITAL AND INTERMEDIATE GOODS NOT READILY AVAILABLE IN INDIA.

3. NEPAL HAS BEEN SUFFERING FROM SUBSTANTIAL TRADE DEFICITS WITH INDIA. AS INDICATED IN RRP ON HETAUDA-NARAYANGARH ROAD PROJECT, DEFICIT IN NEPAL'S TOTAL MERCHANTIS TRADE IN 1974-75 WAS ESTIMATED AT NRS 897 MILLION AS AGAINST ONLY ABOUT NRS 300 MILLION 1970-71. (THIS TRADE GAP HAS BEEN COVERED BY RECEIPTS FROM FOREIGN CAPITAL AND INVISIBLES.) NARROWING OF THIS TRADE GAP IS SEVERELY CONSTRAINED IN FACT THAT PRICES OF NEPAL'S EXPORTS, MAINLY TO INDIA, AND PRE-DOMINANTLY AGRICULTURAL COMMODITIES, HAVE A VERY LOW ELASTICITY OF DEMAND IN INDIA, WHEREAS PRICES OF NEPAL'S IMPORTS, ALSO MAINLY FROM INDIA AND IN FORM OF INDUSTRIAL GOODS, HAVE A HIGH ELASTICITY OF DEMAND IN NEPAL.

4. RATIO OF NEPAL'S TOTAL RESERVES TO HER TOTAL IMPORTS HAD BEEN DECLINING EVERY YEAR, FROM NEARLY 15 MONTHS IN 1972-73 TO NINE MONTHS IN 1974-75. THIS DECLINING RATIO MAY BE DIFFICULT TO REVERSE IN LONG-RUN, ALTHOUGH IT IS NOW REPORTED THAT THERE HAVE BEEN SOME RECENT IMPROVEMENTS IN NEPAL'S EXTERNAL RECEIPTS AND LIMITED OFFICIAL USE

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PAYMENTS POSITION.

5. GOVERNMENT'S CONCERN FOR NEPAL'S INTERNATIONAL RESERVE POSITION HAS BEEN SHARED BY THE INTERNATIONAL MONETARY FUND WHICH GRANTED A RECENT "STAND-BY" TO NEPAL, AND BY WORLD BANK WHICH STATED IN ITS RECENT REPORT (FOOTNOTE: IBRD, REVIEW OF THE ECONOMIC SITUATION OF NEPAL, JULY 22, 1976, PP.2, 35-36.) FOLLOWING:

(A) QUOTE IMPORTS OF CEMENT, IRON, AND STEEL, POL AND INDUSTRIAL EQUIPMENT, ARE LIMITED NOT ONLY BY THE LACK OF FOREIGN EXCHANGE RESOURCES BUT ALSO BY THE REMOTE LOCATION OF THE CONTRY. INDIA HS BEEN FREQUENTLY SHORT OF THESE MATERIALS AND THIS FORCED NEPAL TO COVER PART OF HER NEEDS BY IMPORTING FROM OVERSEAS. THESE IMPORTS HAVE BEEN EXTREMELY EXPENSIVE, PARTICULARLY IN THE CASE OF HEAVY MATERIALS SUCH AS CEMENT.... UNQUOTE

(B) QUOTE IMPORTS HAVE BEEN RISING MORE RAPIDLY THAN EXPORTS AND WILL PROBABLY CONTINUE TO DO SO IN THE FUTURE. UNQUOTE

(C) QUOTE OF COURSE, THERE IS NO REASON FOR NEPAL TO MAINTAIN RESOURCES AT AN EXCESSIVE LEVEL. IN ITS LANDLOCKED POSITION, THE COUNTRY IS, HOWEVER, EXTREMELY VULNERABLE TO TRADE AND TRANSPORT DEVELOPMENTS BEYOND ITS CONTROL. TO PREVENT SUDDEN SHORTAGES, THAT WOULD INTERRUPT DEVELOPMENT ACTIVITIES, FOREIGN RESERVES SHOULD BE MAINTAINED AT A RELATIVELY HIGH LEVEL. IN VIEW OF THIS CONSIDERATION, THERE IS PROBABLY LITTLE ROOM FOR FINANCING OF THE RESOURCE-GAP THROUGH A DRAWDOWN OF RESERVES.

UNQUOTE.

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